

## Community Bank Flexibility Act (H.R. 3287)

### Background and Purpose

The *Community Bank Flexibility Act* (H.R. 3287) would provide a much-needed choice to banks, especially small institutions serving local communities, to allow them to meet new capital demands with the freedom to organize as limited liability companies (LLCs) for tax purposes.

Approximately 90% of US banking organizations have under \$1 billion in assets and are thus widely classified as small. Many primarily serve the needs of local families and businesses. These institutions are a key part of our national economic engine.

Unfortunately, the climate of increasing regulation after the financial crisis of 2008 has put added burden on smaller institutions—a burden that is disproportionate to the risk they pose to the banking system. They need to meet new capital requirements and remain viable while being constrained, unlike other businesses, in the ways in which they can organize. Required to be corporations for tax purposes, banks either have to submit to the double-taxation of C corporations or the stringent limits on number and types of shareholders of S corporations.

The LLC form is established and widespread in many sectors of business. It provides the flexibility of optional pass-through tax treatment, with greater opportunity to raise capital without a limit on the number of members or their interest. Many community banks, uniquely working under capital requirements, could benefit from the LLC form but are obligated to be corporations under Depression-era rules that could not have predicted the existence of LLCs.

Banks, especially smaller institutions, require an opportunity to raise capital in new ways, without introducing new risks into the financial system, in order to thrive in the current climate and continue to provide everyday Americans with important financial services.

### Legislative Solution

The *Community Bank Flexibility Act* would provide opportunities for banks to raise needed capital and be treated like other businesses, without diminishing soundness requirements, by:

- 1) Allowing banks to be organized as LLCs for tax purposes.
- 2) Providing a five-year window for existing banks to reorganize as LLCs without going through the prohibitive tax of a liquidation.
- 3) Preventing unfair use of the LLC election by putting a five-year built-in gains recognition period on C corporations reorganizing as LLCs, similar to those reorganizing as S corporations; and continuing that period for S corporations that reorganize as LLCs less than five years after having been C corporations.

In the current regulatory environment, many banks need the freedom to organize in alternative forms, as other businesses can, in order to meet their capital requirements, grow, and better serve their communities.